

## **Q. TAX-EXEMPT BOND PROGRAM CORRESPONDENCE EXAMINATION TIMELY USE OF PROCEEDS - ARBITRAGE**

by  
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### **1. Introduction**

In 1999, the Service will design and implement a correspondence examination project directed at measuring the level of issuer compliance with the arbitrage rebate requirement of section 148(f) of the Internal Revenue Code. In the 1980s, Congress determined that, in addition to the arbitrage yield restriction rules, arbitrage rebate rules were needed to curb the issuance of investment motivated tax-exempt bonds. The rebate rules were designed to create additional safeguards against issuers obtaining an "arbitrage" benefit by either issuing bonds prematurely or using bond proceeds in an improper or untimely fashion. Given this critical role that the arbitrage rebate rules play in ensuring that bonds are issued for proper governmental purposes, the Service has decided to initiate this project.

### **2. Project Design**

The Service will open correspondence examinations of between 100 and 200 new money tax-exempt bond issues by issuing a letter (sample letter set forth in Addendum A) and a questionnaire (sample questionnaire set forth in Addendum B) to issuers. The bond issues examined will be selected by statistically sampling Forms 8038 filed in 1991 and 1992. Responses to the correspondence examination letter will be reviewed to determine whether any additional examination activity by a field office is warranted. If additional examination activity is unnecessary, the examination will be closed.

Data provided during the examinations will be compiled and evaluated. Initial baseline measurements of noncompliance will be developed from the findings and results of the examinations.

### **3. Use of Project's Results/Findings**

The results of the correspondence examinations will be used to assess the extent to which issuers of tax-exempt bonds are complying with the arbitrage rebate rules. In particular, the Service will assess whether issuers are generally calculating and paying rebate to the Service in a timely manner. If substantial noncompliance is identified in this regard, consideration will be given to developing additional compliance initiatives.

If particular areas of noncompliance are identified through these examinations, the Service will consider publicizing such areas of noncompliance in an effort to educate issuers regarding their legal obligations to pay rebatable arbitrage under section 148(f) of the Code.

### **4. Conclusion**

The arbitrage rebate rules are intended to eliminate any incentive on the part of issuers to issue bonds in order to take advantage of an investment opportunity. This goal can only be met if issuers meet their obligations under section 148(f) of the Code. This project is designed to accomplish the critical task of measuring issuer compliance in this regard.

**ADDENDUM A**

(Sample Letter)

Issuer  
Street Address  
City, State, Zip Code

Person to Contact

ID #

Contact Telephone Number

Date

EIN

Re: [Insert name of bond issue from line 7 of Form 8038 and/or CUSIP number(s) and/or Report Number(s)]

Dear Sir or Madam:

In Announcement 93-92, the Internal Revenue Service (the "Service") announced that it would initiate an expanded compliance program for tax-exempt bonds. We have selected the bond issue named above for examination as part of a correspondence examination project initiated by the Service to measure compliance with the arbitrage rebate requirement of section 148 of the Internal Revenue Code.

The examination relates only to the identified municipal financing arrangement. No other municipal financing arrangements or the general operations of the issuer are within the scope of the examination.

This examination is designed to be conducted through correspondence. Attached you will find a list of questions by which we request certain information regarding the issue under examination. Please submit your reply within 30 days of the date of this letter to:

Key District Office  
Street  
City, State ZIP

Whether further examination activity is necessary with respect to the bond issue will be determined based on your responses to the attached questions.

Issuer Name

If you intend to authorize a representative to represent you with respect to this matter, a power of attorney must be filed with the Service before your representative can receive or inspect confidential information from the Service. A Form 2848, Power of Attorney and Declaration of Representative, or any other properly written power of attorney or authorization may be used for this purpose.

Thank you for your cooperation in this matter. Please feel free to call me at the telephone number listed above.

Sincerely,

(Agent & Contact)

## **ADDENDUM B**

(Sample Questionnaire)

### ATTACHMENT

1. In Part I, line 6, of the Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues, that you filed with respect to your issuance of [Name of Issue], you state that the date of issue of the bond issue was [Date of Issue]. Please confirm that this information is accurate.
2. If the issue has been discharged, please indicate the date that the issue was discharged.
3. Based on the issue date set forth on the Form 8038, the first due date for any necessary rebate payment has passed. Payments of rebate under section 148(f) of the Code must be made for a computation date that is not later than 5 years after the issue date and in 5-year intervals after such date. In addition, a final rebate computation must be made as of the date the issue is discharged. Please provide the following information with respect to your determination of whether you owed rebate on any rebate payment date:
  - a. State the dates you treated as rebate computation dates and rebate payment dates.
  - b. Provide copies of any rebate computations including bond yield computations completed with respect to your rebate liabilities with respect to the issue. If no rebate computations were completed, please explain why such computations were not completed.
  - c. Under the Code and applicable regulations, a variety of exceptions may apply to a bond issue that would reduce or eliminate the requirement to pay over arbitrage earnings. Please state which exceptions, if any, have been relied upon to reduce or eliminate the need to make rebate payments and provide copies of all applicable elections. If any elections constitute part of a larger document, you may, instead of sending the entire document, send the first page, the page(s) that includes the pertinent elections, and the signature page(s).
  - d. Please state the amount of proceeds allocated to reimburse expenditures incurred before the date of issue of your issue.
  - e. If rebate was owed as of any payment dates, were Forms 8038-T, Arbitrage Rebate and Penalty in Lieu of Arbitrage Rebate, filed with the Service and payment made on a timely basis? If yes, provide copies of filed Forms 8038-T. If not, please explain why the Forms were not filed.

- f. Did you elect under section 148(f)(4)(C) of the Code on or before the issue date to pay penalty in lieu of rebate? If you did, please provide a copy of your election. As indicated above, you do not need to send the entire document if the first page, the page(s) including the election and the signature page(s) are provided. Also, provide a schedule or other documentation regarding expenditures and copies of any Forms 8038-T filed to pay such penalties.
- g. Have you made any claims to recover an overpayment of rebate? If so, please provide copies of any claims submitted and any correspondence from the Service indicating a recovery of overpayment from the Service.

These questions are designed to gather the information needed to measure compliance with the arbitrage rebate requirement. Please feel free to provide us with whatever additional information you believe may assist us in this effort.